APPENDIX A

Statutory Provisions Involved

NATURAL GAS ACT

[Act of June 21, 1938, c. 556, 52 Stat. 821, as amended; 15 U.S.C. 717-717w (1964)]

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Rates and Charges; Schedules; Suspension of New Rates

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Sec. 4. (c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services. [52 Stat. 822 (1938), as amended, 76 Stat. 72 (1962); 15 U.S.C. § 717c(c) (1964)].

* * * * * * * * * *

Extension of Facilities; Abandonment of Service

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Sec. 7. (c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That

if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however*, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest. [52 Stat. 825 (1938), as amended, 56 Stat. 83 (1942); 15 U.S.C. § 717f(c) (1964)].

* * * * * * * * * *

OUTER CONTINENTAL SHELF LANDS ACT

[Act of August 7, 1953, 67 Stat. 462;
43 U.S.C. 1331, *et seq.* (1964)]

* * * * * * * * *

Laws and Regulations Governing Lands—Constitution and United States Laws; Laws of Adjacent States; Publication of Projected States lines; Restriction on State taxation and Jurisdiction

Section 4(a)(1)

The Constitution and laws and civil and political jurisdiction of the United States are extended to the subsoil and seabed of the outer Continental Shelf and to all artificial islands and fixed structures which may be erected thereon for the purpose of exploring for, developing, removing, and transporting resources therefrom, to the same extent as if the outer Continental Shelf were an area of exclusive Federal jurisdiction located within a State: *Provided, however,* That mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of this subchapter.

Section 4(a)(2)

To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary now in effect or hereafter adopted, the civil and criminal laws of each adjacent State as of August 7, 1953 are declared to be the law of the United States for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf, and the President shall determine and publish in the Federal Register such projected lines extending seaward and de-

fining each such area. All of such applicable laws shall be administered and enforced by the appropriate officers and courts of the United States. State taxation laws shall not apply to the outer Continental Shelf. [67 Stat. 462 (1953); 43 U.S.C. 1333(a)(1), (2) (1964)].

* * * * * * * * * * *

Administration of Leasing—Rules and Regulations; Amendment; Cooperation With State Agencies; Violations and Penalties; Compliance with Regulations as Condition of Lease

Section 5(a)(1)

The Secretary shall administer the provisions of this subchapter relating to the leasing of the outer Continental Shelf, and shall prescribe such rules and regulations as may be necessary to carry out such provisions. The Secretary may at any time prescribe and amend such rules and regulations as he determines to be necessary and proper in order to provide for the prevention of waste and conservation of the natural resources of the outer Continental Shelf, and the protection of correlative rights therein, and, notwithstanding any other provisions herein, such rules and regulations shall apply to all operations conducted under a lease issued or maintained under the provisions of this subchapter. In the enforcement of conservation laws, rules, and regulations the Secretary is authorized to cooperate with the conservation agencies of the adjacent States. Without limiting the generality of the foregoing provisions of this section, the rules and regulations prescribed by the Secretary thereunder may provide for the assignment or relinquishment of leases, for the sale of royalty oil and gas accruing or reserved to the United States at not less than market value, and, in the interest of conservation, for unitization, pooling, drilling agreements, suspension of operations or production, reduction of rentals or royalties, compensatory royalty agreements,

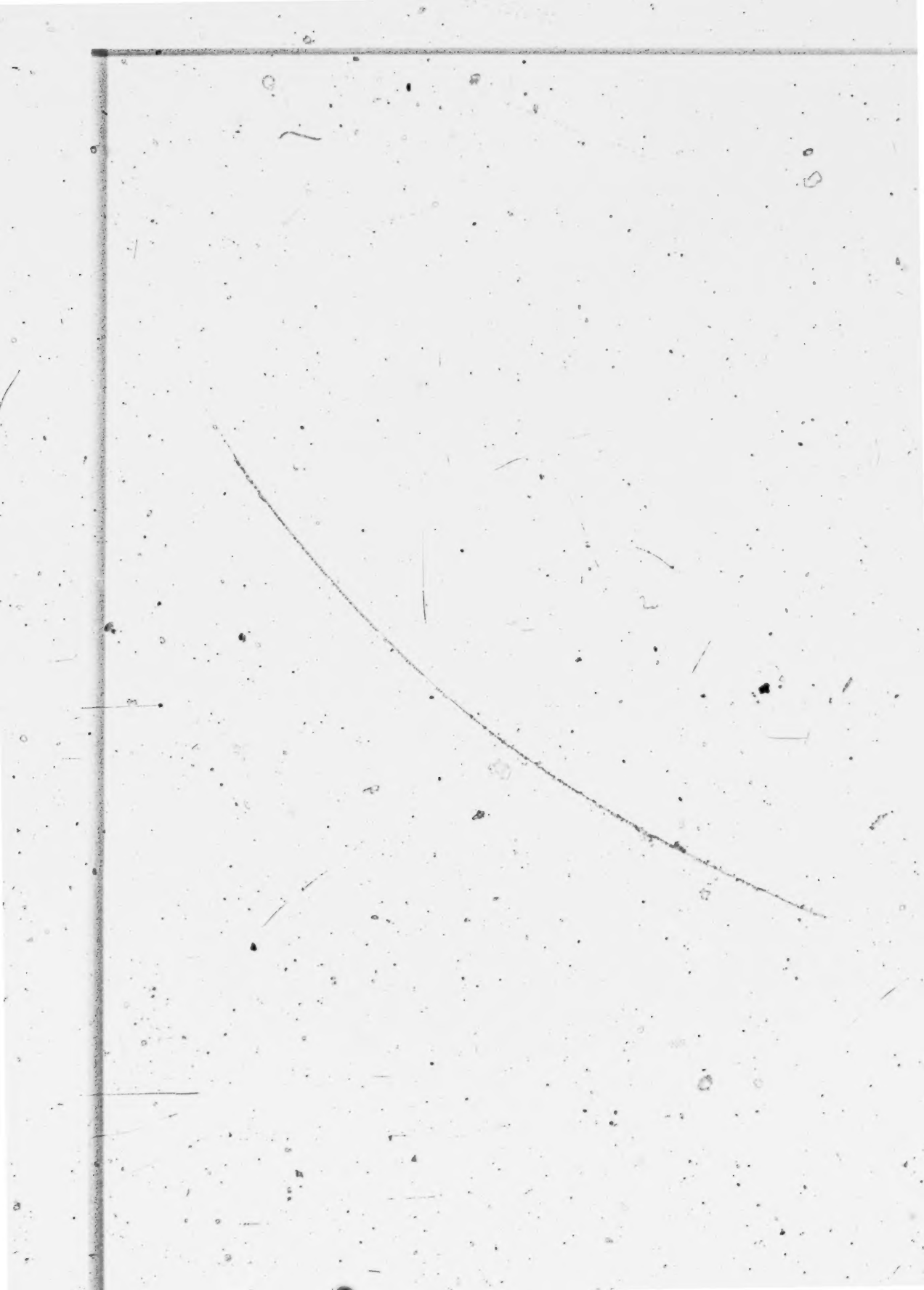
subsurface storage of oil or gas in any of said submerged lands, and drilling or other easements necessary for operations or production.

* * * * * * * * * *

Section 5(c)

Pipeline rights-of-way; forfeiture of grant

Rights-of-way through the submerged lands of the outer Continental Shelf, whether or not such lands are included in a lease maintained or issued pursuant to this subchapter, may be granted by the Secretary for pipeline purposes for the transportation of oil, natural gas, sulphur, or other mineral under such regulations and upon such conditions as to the application therefor and the survey, location and width thereof as may be prescribed by the Secretary, and upon the express condition that such oil or gas pipelines shall transport or purchase without discrimination, oil or natural gas produced from said submerged lands in the vicinity of the pipeline in such proportionate amounts as the Federal Power Commission, in the case of gas, and the Interstate Commerce Commission, in the case of oil, may, after a full hearing with due notice thereof to the interested parties, determine to be reasonable, taking into account, among other things, conservation and the prevention of waste. Failure to comply with the provisions of this section or the regulations and conditions prescribed thereunder shall be ground for forfeiture of the grant in an appropriate judicial proceeding instituted by the United States in any United States district court having jurisdiction under the provisions of section 1333(b) of this title. [67 Stat. 464 (1953); 43 U.S.C. 1334(a)(1), (c) (1964)].



APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 22163

CONTINENTAL OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22867

TIDEWATER OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22868

THE ATLANTIC REFINING COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22869

CITIES SERVICE OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL POWER COMMISSION. (TEXAS CASES).

(December 19, 1966.)

Before WISDOM and COLEMAN, Circuit Judges, and DAWKINS, District Judge.

WISDOM, Circuit Judge: Petitioners, the four Catco companies, seek review of Federal Power Commission orders. The basic question is whether the petitioners' transfer, in

the form of lease-sale agreements, of certain leasehold interests in the offshore Ship Shoal Field is a sale of natural gas in interstate commerce within the meaning of Section 1(b) of the Natural Gas Act.[1] *United Gas Improvement Co.* v. *Continental Oil Co.*, 1965, 381 U.S. 392, 85 S.Ct. 1517, 14 L.Ed.2d 466 (*Range Field* case), upholding the Commission's ruling that it has jurisdiction over a leasehold purchase arrangement controls this case. We find that the transfer is subject to the Commission's jurisdiction. We affirm the Commission's order requiring certification under Section 7 of the Act.

* * * *

Petitioners, the four Catco companies, have jointly developed leasehold interests in the Ship Shoal area off-shore Louisiana obtained for $11,562,017 from the United States government in 1955 under the Outer Continental Shelf Lands Act. On May 10, 1961, by Acts of Sale and Mortgage and Pledge they conveyed these leaseholds to the Tennessee Gas Supply Company and the Tenneco Oil Company, two subsidiaries of the Tennessee Gas Transmission Company, a major interstate pipeline company.[2] The total

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[1] 15 U.S.C. § 717(b): "The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

[2] Negotiations for the Ship Shoal sale had taken place between petitioners and Tennessee Gas Transmission Company. However, the formal instruments effectuating the transaction were executed by Catco and the two subsidiaries of the pipeline, Tennessee Gas Supply Company and Tenneco Oil Company. The gas interests in the leasehold were thereafter assigned to the parent pipeline. This rather complicated arrangement was similar to that employed in the *Rayne Field* transaction; it allowed the parent pipeline company to avoid giving a mortgage on the Ship Shoal properties which would have encumbered its own assets.

consideration was $97,333,333 in cash and notes maturing over 15½ years.

The Commission first considered the Ship Shoal transfer in connection with Tennessee Gas Transmission's 1961 application for certification of an $8.5 million connecting pipeline.[3] Tennessee stated during the course of the proceeding:

> The sole purpose for acquiring the leasehold interests in the Ship Shoal Field was to provide additional reserves and deliverability to meet the natural gas requirements of Tennessee's jurisdictional customers. 30 FPC at 765.

The Catco companies were not parties to the Tennessee proceeding and made no filings with respect to Ship Shoal. The Commission concluded that it could not certify the construction of the pipeline unless it had jurisdiction over the leasehold transfer.[4] Accordingly, the Commission issued the order here on review for petitioners to show cause why their transfer of the Ship Shoal leasehold interests should not be certified under the Act. Tennessee intervened in the resulting FPC hearings and in this appeal. Its application for the Ship Shoal connecting lines has been deferred pending final resolution of the Catco jurisdiction issue now before us.

The examiner found that Catco had drilled seventeen wells in the Ship Shoal Field between acquisition of the

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[3] Tennessee Gas Transmission Co., Opinion No. 403, 30 F.P.C. 759 (1963).

[4] On the basis of the record, the examiner in the *Tennessee* proceeding held that the Ship Shoal transaction involved a sale of natural gas for resale in interstate commerce which was not in the public interest. By Tennessee's own estimates the gas would cost it 28.3 cents per Mcf over a 26 year production period as compared with the area ceiling of 19.5 cents per Mcf. Id., Second Decision of Presiding Examiner, 30 F.P.C. at 801-09, 819-21.

leaseholds in 1955 and May 3, 1960. Seven were completed as oil wells and one as a gas well. The gas well was shut-in and no gas has been produced. The evidence showed seventeen completions in the oil wells and two in the gas well. Gas was found in 46 reservoirs in 39 distinct sand zones and oil in fourteen reservoirs in eight distinct sand zones. In addition, five reservoir sands that produced oil were also productive of gas. Later, drilling on five potential gas wells was commenced but completion was deferred. Production of oil began and the oil was barged inland. The gas well was not hooked up, since Tennessee's application for a pipeline certificate has been deferred.

In 1960 petitioners sought and received several offers for Ship Shoal in the form of both conventional gas purchases and purchases of leasehold interests. Tennessee made offers in both forms. The petitioners chose Tennessee's leasehold purchase offer largely because it produced the greatest discounted net cash flow. Under the Lease Sale Agreement, the four Catco companies each received one-fourth of the total $97⅓ million consideration, $3.1 million in cash and the remainder in notes. The notes are in two series designated "O" and "G", both of them the obligation of Tennessee Gas Supply. One series (the "O" series) is also the obligation of Tenneco, which owns and operates all of Tennessee's domestic oil producing properties. Thus Tenneco's total payment was $12 million ($387,500 cash and remainder in "O" series notes); Gas Supply's was $85⅓ million ($2,712,500 cash and remainder in "G" series notes). The buyers and sellers agreed for purposes of establishing the rights of the parties, that the total quantity of *recoverable reserves* of gas attributable to the leasehold interests was 533,333,333 Mcf and the total quantity of recoverable oil 12,244,898 barrels. This stipulation was partly for the purpose of establishing security. These figures were also used to arrive at comparison levels and unit prices for the redetermination provisions of the agreements. The redetermination provisions, common in

leasehold sales, provide for recomputation of the total price, at the request of any party, during the seventh year following the signing of the agreements. In such event, the recoverable quantities of oil and gas would be redetermined by arbitration proceedings. And the amounts by which the estimates of recoverable reserves were changed above or below 533,333,333 Mcf of gas and 12,244,898 barrels of oil would result in an adjustment in the total purchase price of 16 cents per Mcf (85⅓ million/533,333,333) and 98 cents per barrel ($12 million/12,244,898) above or below those base quantities. The examiner credited testimony that the base quantities represented only an arbitrary present determination of reserves arrived at by negotiation. They are not the average of actual engineering estimates obtained by parties to the transaction. Indeed the figure agreed upon is lower than any actual estimate mentioned in the hearings.

The Ship Shoal lease sale transferred to Tennessee's subsidiaries all mineral rights down to the base of the MI sand, including rights to produce and sell oil, casinghead gas, gas, condensate, and natural gas liquids, as well as related equipment. The Catco companies retained no responsibility for the management or operation of the interests. However, Tennessee was given the option to require petitioners to purchase all the crude oil to be produced from the properties at the average price posted in nine South Louisiana fields. Tennessee insisted on the oil purchase provision to assure a market for the oil, since Tennessee itself is not in the oil business. This option has been continuously exercised since 1962. The note installments are being paid on schedule.

The examiner found that the Ship Shoal transaction, therefore, was a "sale of natural gas for ultimate public consumption within the meaning of the Natural Gas Act.": "This record shows the transfer of a vast reserve of natural gas, located outside the boundaries of any State, into

the hands of a pipeline company whose business is the transportation and sale of natural gas within the United States. * * *" But the examiner concluded that the Commission lacked jurisdiction because of this court's opinion in the *Rayne Field* case[5] that leasehold transactions generally were exempt under Section 1(b) exempting "the production and gathering of natural gas. The Commission adopted the examiner's findings except for his conclusion, which it reversed pending review of the *Rayne Field* case in the Supreme Court. The Supreme Court's *Rayne* decision in favor of jurisdiction came six months later. Thus, the Commission findings before us in Ship Shoal do not reflect the Court's *Rayne* opinion. However, they do provide a sufficient basis for our application of the standards the Court announced in that case.

The Commission order under review directs the petitioners to file, within six months, appropriate rate schedules and applications for certificates and to take other steps necessary to bring the Ship Shoal transfer within the requirements of the Act.[6] However, it should be noted that no questions are before us relating to the propriety of the Commission's disposition of the case following its assertion of jurisdiction. Before us is only the jurisdictional question. Compare *Rayne, supra,* 381 U.S. at 399.

The petitioners concede that there is no dispute regarding the relevant facts. However, they contend that the Commission made a number of ultimate findings not supported by substantial evidence.

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[5] Marr v. Federal Power Comm'n, 5 Cir. 1964, 336 F.2d 320, rev'd sub nom. United Gas Improvement Co. v. Continental Oil Co., 1965, 381 U.S. 392, 85 S.Ct. 1517, 14 L.Ed.2d 466. See 44 Texas L. Rev. 356 (1965).

[6] The Catco Companies filed petitions for review and stay of the orders in the Fifth, Ninth, Tenth and District of Columbia circuits. These orders were granted, and review proceedings were consolidated in this court for all petitioners.

I.

The *Rayne Field* case is the most recent link in the chain of Supreme Court decisions defining the Commission's jurisdiction over wellhead sales by independent producers. The chain began, of course, with *Phillips Petroleum Co.* v. *Wisconsin,* 1954, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035. Since the *Catco* case (*Atlantic Refining Co.* v. *Public Service Commission of New York,* 1959, 360 U.S. 378, 79 S.Ct. 1246, 3 L.Ed.2d 1312), the Commission has attempted to hold producers to prices "in line" with similar sales. But until *Rayne* one class of gas transfer had eluded the Commission's jurisdiction: the transfer of leasehold interests in developed fields. The obstacle to Commission regulation of these leasehold transfers was *Federal Power Commission* v. *Panhandle Eastern Pipeline Co.,* 1949, 337 U.S. 498, 69 S.Ct. 1251, 93 L.Ed. 1499. In that case the Court stated flatly, "Of course leases are an essential part of production", 337 U.S. at 505, 93 L.Ed. at 1505, and therefore fall under the Section 1(b) "production and gathering" exemption.

In *Rayne* the Court construed the "production and gathering" exemption as applicable to "state regulatory power over by physical processes of production or gathering in furtherance of conservation or other legitimate state concerns", but not to sales of the kind "affirmatively subjected" to Commission jurisdiction. 381 U.S. at 403. In effect, the Court broke down the sharp distinction between the conventional sale of wellhead gas and the sale of leasehold interests that had prevailed since *Panhandle.* Under *Rayne,* the lease transfer is no longer to be arbitrarily excluded, purely as a matter of form, from Commission jurisdiction. The test is not whether the transaction in question is in form a lease-sale or a sale of gas. The transaction may be a lease-sale in accordance with local law and a sale of gas under the Act. "Without impugning in any way the good faith and genuineness of the transac-

tions, we think it clear that the lease-sales here in question can nonetheless be considered 'sales' of natural gas in interstate commerce for purposes of the Act." 381 U.S. at 400. The Court directed a case-by-case analysis of the substance of each transfer. The test is three-pronged:

> (1) Is the economic effect of the transfer similar to that of a conventional sale?
>
> (2) Is the subject of the transaction "proven and substantially developed" reserves?
>
> (3) Is the transfer of the reserves for purpose of interstate transmission and resale?

The Court made it clear that the economic effect on the parties could deviate somewhat from conventional sales. The fundamental inquiry is whether "the sales of these leases in . . . a proven and substantially developed field . . . accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other *States. That is the significant and determinative economic fact.*" (Emphasis added.) 381 U.S. at 401. Employing this case-by-case approach, the Court distinguished *Panhandle,* where the leases were undeveloped and the sale was in *intra*state commerce. In a summary opinion based on *Rayne* the Court has also affirmed Commission jurisdiction over transfer of the Bastian Bay Field leases. *Federal Power Commission* v. *Pan. American Petroleum Corp.,* 1965, 381 U.S. 762, 85 S.Ct. 1802, 14 L.Ed.2d 714, rev'g 10 Cir. 1964, 339 F.2d 694, rev'g 30 F.P.C. 1477 (1963).

II.

The petitioners contend that the Ship Shoal transaction is sufficiently different in economic effect from *Rayne* to preclude its characterization as a jurisdictional sale.

A. The Ship Shoal assignment they contend, was not a substitute for a conventional sale of gas, as the lease trans-

fer was in *Rayne*. In *Rayne* the sellers first executed conventional sales contracts, but later withdrew their application for certification when it appeared that, because of the *Catco* case,[7] the Commission might not approve the application. Here the petitioners requested several prospective purchasers to make an offer for the leases and, alternatively, an offer for a conventional purchase of gas. The plan was to obtain "a basis for economic comparison" between the two different types of sales. Present value was the common denominator. The chief objective was the highest possible discounted net cash flow. Analysis showed that the discounted net cash flow for a Catco company from 22 years of continuous operations would be $7,449,000; but that from a lease sale to Tennessee it would be $8,598,000 payable in only 16 years. We do not find this a significant difference between the two plans. The Supreme Court had the same distinction open to it in *Rayne*, which also involved a 16-year note repayment plan. The difference in economic effect between the two figures of net cash flow is principally that between similar earnings discounted over 16 years and 22 years. It goes more to the method of payment than to the substantial economic effect of the transfer.

B. The Ship Shoal assignment, petitioners argue, is distinguished from the *Rayne* transaction by the transfer of all mineral interests and control to the buyer. In *Rayne*, the Court noted that the lease-sales were to cover no minerals except natural gas and condensate, all other mineral rights being reserved to the lease-sellers. By a management agreement one of the sellers was to continue the bulk of production work. The Ship Shoal lease agreement, however, transferred all the leasehold interests including the

[7] Public Serv. Comm'n of New York v. Federal Power Comm'n, 3 Cir. 1958, 257 F.2d 717, *aff'd sub nom.* Atlantic Refining Co. v. Public Service Comm'n of New York, 1959, 360 U.S. 378, 79 S.Ct. 1246, 3 L.Ed.2d 1312.

right to produce and sell oil, casinghead, condensate, and natural gas liquids. The petitioners retained no role in the control or management of the properties conveyed. But these differences between the two transactions are blurred by related similarities. Although the Ship Shoal agreement transferred both gas and oil rights, Tennessee has repeatedly sought to purchase the oil leaseholds if the Catco companies would continue to develop and operate them or, alternatively, that Tennessee would take back the oil extracted by Tennessee at a mutually agreeable shore point. In the final agreement the petitioners gave Tennessee the option to require Catco to purchase crude oil produced from the properties at the average posted price. As stated by one witness for Catco, "Tennessee was not in the oil business although it was affiliated with a company [Tenneco] that was. Tennessee insisted on assurance that it would have a market for the crude and receive for it the price current at the time of production."[8] In exercise of the option Tennessee has sold back to Catco virtually all oil taken from Ship Shoal. This may not be a "wash sale" in the usual sense, but it is clear that Catco's obligation to repurchase the crude oil represents a significant retained interest in Ship Shoal. The petitioners assumed the functions and risks of refining and marketing the Ship Shoal oil.

Similarly, the differences in control and management between the *Rayne* and Ship Shoal arrangements is not substantial enough to defeat jurisdiction. The buyer in *Rayne,* even though without operational responsibility, still enjoyed the right to make major production decisions such

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[8] The Crude Oil Purchase recited:

"*A principal condition of Seller and moving consideration to Seller* in entering into such lease acquisition transaction is this agreement on the part of Buyer to purchase the quantities of crude oil produced from said leases which Seller hereby is granted the right to sell to Buyer and Buyer hereby agrees to purchase." (Emphasis added.)

as determining the volume of gas to nominate for production each month and whether new wells should be drilled.[9] In Ship Shoal, the buyer takes the operational responsibility along with the important policy decisions. Ship Shoal in this respect is similar to the *Bastian Bay* transaction over which the Court affirmed FPC jurisdiction. Tennessee in that case also was to operate and to complete development of the field.[10]

C. Indeed we perceive numerous identities between Ship Shoal and the two lease-sale transactions ruled on by the Supreme Court. The payment for the Ship Shoal leases, as in *Rayne,* is represented by notes spread over a 16-year period, and the notes have an acceleration clause geared to production, apparently as a security device. And an intermediate corporate structure shields the pipeline company from principal obligation on the notes to the producers. And as in *Bastian Bay,* the Ship Shoal agreement provides for a redetermination of the gas reserves at a future period.

We conclude that here, as in *Rayne* and *Bastian Bay,* the economic effect of the transfer does not differ enough from a conventional sale to defeat Commission jurisdiction.

III.

The petitioners contend that the Ship Shoal gas reserves do not meet *Rayne's* "proven and substantially developed" test. There was little question on appeal that *Rayne* was a proven and substantially developed field. Thus the Court felt no need to spell out this standard in that case. It justified the test with this rationale:

> "The substantiality of development is a relevant consideration, for the more that must be done before the

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[9] 381 U.S. at 396 & n. 4, 85 S.Ct. at 1520, 14 L.Ed.2d at 469.

[10] 30 F.P.C. at 1482, 1490, 1504.

gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce. . . ."[11]

The Supreme Court did not say that such proof of substantiality is the only consideration. Starting with that rationale, however, we conceive the applicable standard to be as follows: Have the leaseholds been sufficiently proved and developed for imminent production of natural gas in commercial quantities? Two criteria emerge from this standard. One is definability of gas volume based upon proof of reserves; the other is imminent ability to produce in commercial quantities. The Commission did not direct its findings expressly to these issues since, as we have noted, its opinion preceded that in *Rayne*. However, the Commission did make numerous findings, supported by substantial evidence and elaborated in its brief, to justify our holding that the Ship Shoal leaseholds were "proven and substantially developed."

Tested under the "proven and substantially developed" criteria, as we conceive them, both *Rayne* and *Bastian Bay* fields deserve a high rating. In *Rayne Field*, 19 wells were in the ground, and 7 more were to be drilled.[12] Natural gas would and did begin to flow in commercial quantities into the buyer's system immediately upon completion of

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[11] 381 U.S. at 403, 85 S.Ct. at 1524, 14 L.Ed.2d at 474.

[12] 381 U.S. at 396 & n. 3, 85 S.Ct. at 1520, 14 L.Ed.2d at 469. The Court and opinions below did not state whether all of these were gas wells, but we will assume they were. Nor do the opinions state whether these wells were drilled at the time of the sale or not until the 1963 show cause hearing. Texas Eastern Transmission Corp., Opinion No. 378, 29 F.P.C. 249, 264-65 (1963).

its connection with the field.[13] Although there was controversy at the hearing level over the extent of the Rayne reserves, the Commission found them to be of "substantial size." Total estimated recoverable reserves were about 990,000 Mmcf.[14] There was further evidence of possible additional reserves in the Rayne untested sands. The Commission considered Rayne a "fully developed" field.[15] The situation was similar at *Bastian Bay*. The seller had drilled 32 wells and achieved 21 oil completions and 20 gas completions. The field had fifteen gas wells and five oil and gas wells, either wholly or partially subject to the transferred leases, which were promptly connected to the buyer's collection system.[16] Commercial quantities of natural gas began to flow into buyer's lines at the time of the connection.[17] The parties stipulated in the lease sale agreement that recoverable reserves of gas transferred were

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[13] Texas Eastern constructed and connected its facilities to *Rayne Field* in the time between a Commission certification order and its reversal by the District of Columbia Court of Appeals. Between the date the facilities were placed in operation and January 1, 1961 (less than a year), Texas Eastern took approximately 65,000 Mcf of natural gas from Rayne Field into its interstate system. See Texas Eastern Transmission Corp., *supra*, Note 12 at 264.

[14] Texas Eastern Transmission Corp., Opinion No. 378, 29 F.P.C. at 251 (1963).

[15] Texas Eastern Transmission Corp. (G-12446), 21 F.P.C. 860, 861 (1959).

[16] Tennessee Gas Transmission Co., Opinion No. 413, 30 F.P.C. 1477, 1493 (1963).

[17] Tennessee installed a 2.63 mile line to Bastian Bay under a budget-type authorization before the Commission asserted jurisdiction over the lease-sale. At the time of the hearing for a regular § 7 authorization, production from Tennessee's Bastian Bay reserves was about 40,000-50,000 Mcf per day; this was about 1⅓ years after Tennessee connected its line to the field. Tennessee Gas Transmission Co., Opinion No. 413, 30 F.P.C. 1477, 1479, 1502 (1963).

759,350,000 Mcf. Although the buyer in *Bastian Bay,* also Tennessee, was able to complete the development of the field, there apparently was no controversy that it was extensively developed at the time of the sale.[18]

Ship Shoal obviously was not as extensively developed as were *Rayne* and *Bastian Bay Fields;* it had only one gas well compared with nineteen and fifteen respectively in the other two fields. But "even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation". *Phillips,* 347 U.S. at 402. We conclude that Ship Shoal had reached the stage of proof and development necessary to satisfy the *Rayne* criteria.

A. Tennessee's faith in the amount of Ship Shoal reserves destined for interstate consumption indicates that the field had at least been developed to the point where a reasonable estimate could be made as to the available reserves. Ship Shoal was a bargained transaction among corporations with vast experience, not only in the petroleum business, but also in the Louisiana fields. The prospective buyer, Tennessee, as might be expected, asserted throughout the negotiations the lowest estimate of net recoverable reserves. Tennessee's estimate was 530,000 Mmcf. The prospective sellers' estimates ranged from about 730,000 to 823,000 Mmcf. Even at the time of closing, there remained a wide variance in reserve estimates among the parties for the purpose of setting the total price. In the end, however, Tennessee was willing to invest over $97 million on its faith in the lowest of the reserve estimates, 530,000 Mmcf., subject to a redetermination provision similar to that used in *Bastian Bay.* And Tennessee applied forthwith to the Commission for transmission certificates based on an estimate of 533,402,000 Mcf in available reserves.[19]

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[18] See *Id.* at 1504.

[19] Tennessee Gas Transmission Co., Opinion No. 403, 30 F.P.C. 759, 762 (1963).

We recognize that estimates of reserves in Ship Shoal may vary considerably until the field is fully drilled and there is productive history over a period of years under operating conditions. But Catco has conceded that a definite and definable volume of gas cannot be determined down to the last cubic foot even after a well has been fully depleted. One can make only estimates of gas. There are some producing areas where it is possible to estimate recoverable reserves with a high degree of accuracy although the particular leases are undrilled and undeveloped. In offshore fields and in South Louisiana, however, reserve estimates are more difficult to determine even after full development because of multiple formations and faulted reservoirs. The effect of redetermination provision is to negate or to diminish substantially the shifting of the risk relating to gas deliverability from the petitioners to Tennessee. We conclude that the recoverable reserves in Ship Shoal field were sufficiently definable to satisfy the *Rayne-Bastian Bay* requirement of proof. The Commission's findings in this regard are supported by substantial evidence.

B. Similarly, Tennessee's readiness to connect its lines to Ship Shoal is a strong indication that the field was "substantially developed" at the time of transfer. Tennessee relied heavily on the Ship Shoal reserves in support of its 1960-62 applications for expanded pipeline facilities.[20] It was aware that in comparable situations the Commission generally grants authorization on the condition facilities will be constructed and placed in actual operation within one year of certification.[21] Tennessee estimated that its Ship Shoal operations could begin in 1963, with first-year gas operating and maintenance expense of $853,400 (no well-workover expense) and similar expense of over $1.3

[20] *Id.* at 765.

[21] *Id.* at 770. See F.P.C. Reg. § 157.20(b), as amended (1957).

million per year for the next 16 years.[22] The presiding examiner in the 1963 *Tennessee* proceeding concluded that the Ship Shoal gas had been "ready for action since 1960, can be and should be connected without further delay," but for the unresolved *Catco* jurisdictional question and related procedural issues. He agreed that the Ship Shoal gas, the "adequacy of its reserves *and deliverability,*" was essential to support Tennessee's 1960-62 applications for increased service.[23]

The Catco witnesses in the present proceeding did not refute the evidence of Ship Shoal's imminent ability to produce gas in commercial quantities. *Cf. Continental Oil Company* v. *Federal Power Commission*, 5 Cir. 1957, 247 F.2d 904, 907. It appears that two completions in one gas well could have been piped up and produced immediately, although the five deferred wells would need further development by Tennessee. Catco conceded that it could have taken certain steps leading to the production of one or more of the wells. Further a Catco expert estimated that once production began, as much as 10 per cent of the reserves could be extracted in less than four years.

It may well be that Ship Shoal is a "long way" from being fully developed. Catco anticipated that from 34 to 40 additional completions would be necessary to calculate the final consideration in the seventh year redetermination of reserves. But this problem relates more to determination of final consideration, than to imminent ability for production. The "substantial and determinative economic fact" is that Catco transferred a large volume of natural gas, definable within a range of reliable engineering estimates, to a jurisdictional pipeline company for imminent interstate transmission. The Commission's findings, sup-

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[22] Tennessee Gas Transmission Co., *supra* note 19, Second Initial Decision of Presiding Examiner, 30 F.P.C. at 803.

[23] *Id.* at 798.

ported by substantial evidence, lead us to the conclusion that Ship Shoal was "proven and substantially developed" under the standards of *Rayne* and *Bastian Bay*.

IV.

We see no merit in petitioners' contention that the Ship Shoal transfer was not a sale in interstate commerce.[24] Tennessee, an intervenor in these proceedings, has shown an unequivocal intention to connect Ship Shoal to its interstate transmission system. Its application to expend $8.5 million for a connecting line remains pending; it was deferred only until settlement of the Commission's jurisdiction over the underlying transfer. Moreover, the Ship Shoal field *is located outside the borders of any state and any gas taken will have to be transported across state lines for sale* within the United States. The petitioners do not deny the truth of these jurisdictional facts, and they have not offered any evidence to show that the Ship Shoal gas is not destined for ultimate public consumption in other states when Tennessee completes its planned transmission facilities. See *Continental Oil Co.* v. *Federal Power Comm'n*, 5 Cir. 1957, 247 F.2d 904, 907.

The petitioners contend also that Tennessee remained free even to reject a proffered certificate to connect with its $85⅓ million Ship Shoal reserves. But the Commission cannot decline jurisdiction of a gas sale on the mere possibility that the buyer may eventually reject Commission authorization of the connecting line. Tennessee has already paid millions of dollars for the leasehold, is con-

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[24] Section 2(7) of the Natural Gas Act, 15 U.S.C. § 717a(7), defines interstate commerce as follows:

> "'Interstate commerce' means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place thereof, but only insofar as such commerce takes place within the United States."

tinuing to make regular payments toward the total price of $85 million, and its application to transport Ship Shoal gas in interstate commerce is pending. Similarly, the Commission cannot abstain from exercising jurisdiction of petitioners' sales on that basis. See *Atlantic Refining Co.* v. *Public Service Comm'n of New York,* 1959, 360 U.S. 378, 387, 79 S.Ct. 1246, 3 L.Ed.2d 1312, 1318.

The Ship Shoal transaction may be distinguished from *Panhandle* in the same way as *Rayne:* The Ship Shoal leases were developed and the sale of the natural gas was in interstate commerce.

V.

Petitioners further assert that the Outer Continental Shelf Lands Act of 1953 [25] (OCSLA) precludes classification of the Ship Shoal transfer as a Gas Act sale. The Ship Shoal leases, unlike those in *Rayne* and *Bastian Bay,* were originally granted by the United States through the Department of the Interior under the OCSLA. Section 4(a)(1) of the OCSLA provides that "mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of this Act." [26] And Section 4(a)(2) makes the laws of the adjacent state (here Louisiana) federal law for the outer Continental Shelf " to the extent that they are applicable and not inconsistent with this Act or with other Federal laws and regulations of the Secretary [of Interior]." [27] As petitioners read these provisions, Louisiana law determines, as a matter of federal law, whether a particular instrument constitutes an assignment of a lease or a sale of hydrocarbons. The catch is that Louisiana does not recognize a sale of gas in place. *Frost Johnson Lumber Co.* v. *Salling's Heirs,* 1923, 150 La.

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[25] 43 U.S.C. §§ 1331-1343.

[26] 67 Stat. 462 (1953), 43 U.S.C. § 1333(a)(1).

[27] 67 Stat. 462 (1953), 43 U.S.C. § 1333(a)(2).

756, 91 So. 207; La. Rev. Stat. Tit. 9, § 1105; La. Code of Civ. Proc., Art. 3664. This feature of Louisiana law did not frustrate the Supreme Court in *Rayne*. Presented with a conflict between federal and state law, the Court refused to allow the Gas Act to be "hamstrung" by "technical concepts of local law." 381 U.S. at 400 & n. 7, 85 S.Ct. at 1522, 14 L.Ed.2d at 472.

In this case the petitioners frame the conflict as one between two federal statutes—the Gas Act on the one hand and Louisiana law applied through the OCSLA on the other. This view of the OCSLA overlooks the express statutory exception to application of state law. Louisiana laws would apply under OCSLA § 4(a)(2) only "to the extent . . . *not inconsistent with* . . . other Federal laws." The Supreme Court has already held in *Rayne* that Louisiana's failure to recognize the sale of gas in place is inconsistent with application of the Gas Act. Louisiana's characterization of the Ship Shoal transaction, to the extent it conflicts with the Gas Act definition of the transaction, is inapplicable.

This result is fully consistent with the respective purposes of the OCSLA and the Gas Act. Congress passed the OCSLA solely to regulate the "leasing and development * * * of the oil potential of the Continental Shelf." H.R. Rep. No. 413, 83d Cong., 1st Sess. 2-3 (1953), 2 U.S. Code Cong. & Ad. News 2178 (1953). The OCSLA makes no provision for the regulation of gas sales of independent producers.[28] In contrast, "protection of consumers against exploitation at the hands of natural-gas companies was the primary aim of the Natural Gas Act," *Phillips Petroleum Co.* v. *Wisconsin, supra,* 347 U.S. at 685. The "congressional intent [was] to give the Com-

[28] The *Phillips* decision in 1954, extending FPC jurisdiction to independent producer sales, did not come until one year after passage of the OCSLA.

mission jurisdiction over the rates of all wholesales of natural gas in interstate commerce." Id. at 682. The plain meaning and legislative history of the statutes show, at least in this case, that the OCSLA and the Gas Act must be applied reciprocally in furtherance of their individual regulatory purposes.

* * * *

The crucial fact here, as in *Rayne,* is that the assignment of the leases accomplished the transfer of large amounts of substantially proven off-shore natural gas reserves to an interstate pipeline company for eventual resale in interstate commerce. The transaction was a sale of a definable volume of gas, the price of which was geared to the actual volume found, and payment for which was directly related to its production—even if there has also been a transfer of an interest in real property. If such sales were not subject to Commission regulation, an "attractive gap" in the regulatory system would be created, and the producing states would be unable to close it. *California* v. *LoVaca,* 1964, 379 U.S. 366, 369-71, 85 S.Ct. 486, 13 L.Ed.2d 357. Since only the jurisdictional issue is before us in this proceeding, we simply affirm the Commission's order directing the petitioners to make filings and take other steps necessary to comply with the provisions of the Natural Gas Act.

The order is AFFIRMED.

No. 22163

CONTINENTAL OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22867

TIDEWATER OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22868

THE ATLANTIC REFINING COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

No. 22869

CITIES SERVICE OIL COMPANY, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL POWER COMMISSION. (TEXAS CASES.)

Before WISDOM and COLEMAN, Circuit Judges, and DAWKINS, District Judge.

Judgment

This cause came to be heard on the petitions of Continental Oil Company, Tidewater Oil Company, The Atlantic Refining Company, and Cities Service Oil Company, for

review of Orders of the Federal Power Commission issued on October 23, 1964 and December 21, 1964, in Docket Nos. RI64-129, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the Orders of the Federal Power Commission in these causes be, and the same are hereby, affirmed.

December 19, 1966

Issued as Mandate:

[Filed, January 27, 1967]

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 22163

CONTINENTAL OIL COMPANY, *Petitioner,*

v.

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FEDERAL POWER COMMISSION, *Respondent.*

PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL POWER COMMISSION. (TEXAS CASES).

(Jan. 27, 1967)

On Petition for Rehearing

Before WISDOM and COLEMAN, Circuit Judges, and DAWKINS, District Judge.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause is hereby DENIED.